

ICPS newsletter

Economic growth in Ukraine will continue

The tenth issue of ICPS's Quarterly Predictions journal will be published this week. ICPS economists predict that a consistent economic policy and favourable conditions in foreign markets will promote economic recovery in Ukraine. Optimistic expectations on the part of businesses and households will stimulate demand. Growth, however, will be hindered by the lack of structural economic reforms. GDP will increase by 1% in 2000 and by 2.5% in 2001

GDP in Ukraine declined by only 0.4% last year, which was the smallest rate of decline in recent years. Domestic demand recovered, due to softer budget and monetary policies. At the same time, foreign demand also increased, due to improved conditions in world markets and real depreciation of the hryvnia. The increase in demand, however, could not offset the decline in agriculture, transport, and construction, due to intrinsic weaknesses in these sectors.

We have adjusted our forecast for GDP growth upwards over the next several years: it will reach 1% in 2000 and 2.5% in 2001. Further increase in demand this year will be determined by strengthening household and business confidence in government policy, as well as by favourable conditions in foreign markets. However, the unreformed economic structure will restrict growth on the supply side. The results of improved economic policy will already be seen in 2001: consistent policymaking will lead to successful structural changes in the Ukrainian economy, which will match expectations on the demand side.

We built our forecast on the following assumptions:

- **Political stability.** Legislative and executive bodies in Ukraine will harmonise their aims and agree on supporting the government reform program.
- **Reform of government machinery.** Economic policy will become more rational and consistent. This will become possible after new procedures for the preparation and consideration of Cabinet of Ministers rulings are established, which will ensure consistency of these decisions with the top priorities of state policy.
- **Sound budget policy.** An austerity policy will help reduce budget expenditures, therefore making tax policy more predictable. A surplus budget may be executed both in 2000 and 2001.
- **Contract enforcement.** State policy should mandate complete execution of any agreement or legislative act.
- **Increasing productivity.** Enterprises will begin to use their resources more effectively after private owners take over majority shares. The process will accelerate after a widescale privatisation, projected for the next two years.

The risks to our forecast are the following:

- Private owners may refuse to restructure Ukraine's sovereign debt, which will discredit the Ukrainian government¹ completely.

¹ The government proposed to restructure its bonds held by private lenders in the sum of \$1.9 billion; Ukrainian government bonds can be exchanged for eurobonds which mature in 4.5 years, if no less than 85% of the holders agree to these terms.

Government becomes more accountable for reforms

The new Ukrainian Cabinet has received a vote of confidence to reform the Ukrainian economy. The establishment of a rightist majority in the Verkhovna Rada (under pressure of referendum and due to changes in the voting procedure²) ensures support for government proposals in the parliament. At the same time, the government becomes more responsible for the quality of draft laws on economic issues and the implementation of legislation.

Political stability, however, remains volatile, since:

- The Constitution of Ukraine does not clearly define the degrees of political accountability granted to the government and the Verkhovna Rada. The parliament may vote for the Cabinet's resignation if the latter does not carry out its action program. The parliament can use this right for only a year after the program is approved; meantime, the President can dismiss the Cabinet at any time. Being more dependent on the President, the government tries to avoid responsibilities before the Verkhovna Rada (for example, the Cabinet headed by Valeri Pustovoitenko did not submit any action program to the Rada for two years).
- The rules of order of the Verkhovna Rada do not determine procedures which would promote stable support of the government in the parliament, since it does not determine the rules for collaboration between the minority and the majority. The Ukrainian parliament continues to work according to the rules of order established in 1994, which do not correspond to the norms of the current Constitution or the principles adopted in 1998 of electing deputies according to a mixed-representation system.

An important step of the new government will be the submission of its action program to the parliament. Approving the program in the parliament will force the government to affirm its procedural accountability before the parliament and obtain the support of deputies. What is even more important, approval of the action program will make economic policy more predictable. Risks to the consistent accomplishment of market reforms are (1) the unstable majority of the parliament; and (2) inconclusive arguments of the government in justifying its decisions before the Verkhovna Rada.

² From now on, all voting in the Verkhovna Rada will be according to the roll call.

In our opinion, although the terms of restructuring are rather attractive for creditors, the restructuring may misfire if the International Monetary Fund refuses to collaborate with Ukraine. Considering the charges against the National Bank of Ukraine of misusing funds from the IMF in 1997–1998, a break in collaboration with the IMF seems possible.

• Conditions in foreign markets may worsen. In 1999, Ukrainian heavy industry became highly dependent on sales in world markets. Worsening conditions in world markets of raw materials (for example, a decline in prices on metals) will lead to a sharp drop in industrial output, since domestic producers are slow to re-orient on new markets. ■

Last Week

Businesses discussed a work plan for this year. A meeting of the Board of the Coordination and Analysis Centre for Ukrainian Business Associations (CACUBA) was held at ICPS on February 24. ICPS is one of 31 CACUBA members. Mr. Yuri Yekhanurov, first deputy premier minister of Ukraine and CACUBA president, chaired the Board meeting.

Participants of the meeting defined CACUBA activities for this year. In order to make government decisions more open and transparent, it was determined to initiate establishing a civic board on the government committee on economic policy. Mr. Yekhanurov noted that the first meeting of this board would be held in the period of March 9–15, 2000.

Another CACUBA objective is the organisation of regional offices, which will ensure the implementation of the idea of open decision-making at the local level, and the consolidated participation of regional business associations and the national associations in the process of developing and approving local authorities' decisions. Participants agreed to establish CACUBA regional offices in Lviv, Ternopil, Kharkiv, Odesa, and Dniprodzerzhynsk.

CACUBA plans for the immediate future involve a campaign for improving legislation on non-government organisations, striving for further introduction of simplified small business taxation, approving the National Program for Promoting Small Business Development, and implementing a number of measures for reforming the national system of certification and accreditation.

Next Week

ICPS experts on Ukraine's relations with international donors.

An article by ICPS experts was published in the *Kievskie vedomosti* newspaper on February 28. This article highlights Ukraine's relations with international financial institutions concerning the accusation of misusing IMF funds and external debt restructuring.

ICPS representatives made the following statement in the article: Due to the inconsistent current policy of international financial institutions regarding Ukraine, the Ukrainian government, which has resolved in favour of decisive economic reforms, must take an active position in its relations with donors.

ICPS Newsletter is a weekly publication of the International Centre for Policy Studies delivered by electronic mail. To be included in the distribution list mail to: marketing@icps.kiev.ua.

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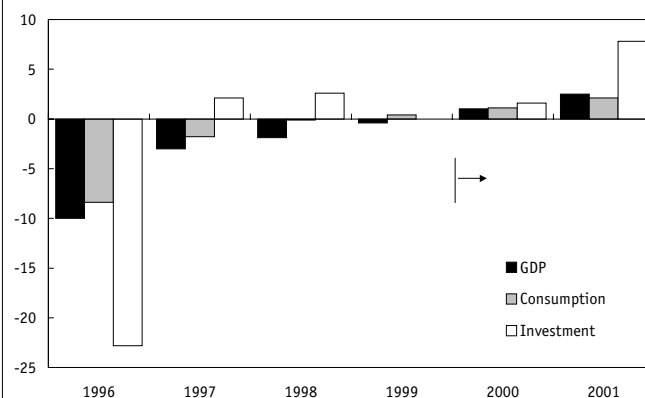
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GDP, consumption, and investment

Real annual % change



Source: State Statistics Committee; forecast by Quarterly Predictions.

Major indicators

	1999 (est.)	2000 (forecast)	2001 (forecast)
Economic activities			
GDP, millions UAH	127126	157200	180100
Real GDP, apc*	-0.4	1.0	2.5
Real industrial production, apc	4.3	2.0	3.0
Real agricultural output, apc	-5.7	1.0	2.5
Gross investment, % of GDP	19.8	19.9	20.9
Direct investment, millions USD (1)	437	700	900
Real household disposable income, apc	1.2	1.0	4.0
Real retail turnover, apc	-4.8	3.5	7.0
Prices			
Consumer price index, apc	19	17	11
Producer price index, apc	16	18	13
Labour market			
Population, millions	49.8	49.4	49.1
Real wage, average apc	-5.7	1.0	1.5
Official unemployment rate, %	4.3	6.0	9.0
Foreign economic activities (1)			
Exports of goods&services, apc	-9.5	3.1	4.2
Imports of goods&services, apc	-21.3	4.3	5.8
Current account balance, % of GDP	2.6	2.1	0.7
Budget			
Revenues, % of GDP	25.7	26.5	26.8
Current deficit, % of GDP	1.5	-0.4	-0.7
Monetary indicators			
Monetary base, apc	39	18	14
M3, apc	40	21	19
NBU international reserves, millions USD	1160	1450	1750
Official exchange rate at year end, UAH/USD	5.21	6.3	7.1
Weighted interest rate on loans, yearly % (3)	55	48	38
International			
World GDP, apc	3.0	4.0	3.8
GDP of Ukraine's major trading partners (2/3 of exports), apc	3.0	3.1	3.2

* apc = annual percent change

Notes:

(1) according to the NBU

(2) commercial bank loans, hryvnias

Source: State Statistics Committee, NBU, Finance Ministry; calculations and forecast by Quarterly Predictions.